

Office of Chief Counsel
Internal Revenue Service

memorandum

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RTBennett

date: **APR 19 2002**

to: [REDACTED], Team Coordinator

from: Area Counsel
(Heavy Manufacturing and Transportation:Edison)

subject: [REDACTED]: Conversion to LLC
Taxpayer: [REDACTED]
EIN: [REDACTED]
UILs: 6501.08-00; 6901.02-00; 6901.03-01; 7701.00-00

This advisory memorandum revises the advisory memorandum previously provided on this issue dated March 28, 2002. The only revisions concern the language of the Forms 872 as stated on pages 4 and 5 below. Please substitute this advisory memorandum for the one dated March 28, 2002. This advisory memorandum should not be cited as precedent.

I. Facts.

The taxpayer, [REDACTED] ("[REDACTED]") filed a consolidated income tax return for tax year ending [REDACTED]. Prior to [REDACTED], [REDACTED] ("[REDACTED]") was a corporation incorporated in Delaware. [REDACTED] was not part of [REDACTED]'s consolidated group. Prior to [REDACTED] [REDACTED] was owned by the following entities (and in the following amounts): [REDACTED] ([REDACTED]%), [REDACTED] ("[REDACTED]"), a Bermuda corporation ([REDACTED]%) and [REDACTED] ("[REDACTED]") a U.S. corporation ([REDACTED]%). [REDACTED] wholly owned [REDACTED] and [REDACTED]. [REDACTED] was the holding company of numerous domestic subsidiaries.

On [REDACTED], [REDACTED] and [REDACTED] adopted a plan of liquidation and resolved that [REDACTED] would be completely liquidated into [REDACTED] and that the assets of [REDACTED] would become the assets of [REDACTED] upon the liquidation under Bermuda law. The effective date of the liquidation was [REDACTED]. On [REDACTED]

██████████ transferred all of its assets and liabilities to ██████████.

On ██████████, ██████████, ██████████ and ██████████ entered into a redemption agreement whereby the shares of ██████████ in ██████████ were redeemed effective ██████████.

On ██████████, ██████████ was converted under Delaware law into a limited liability company ("██████████"), the effective date of the conversion was ██████████.

For federal tax purposes, ██████████ treated the conversion of ██████████ to an LLC as a change of ██████████ from a corporation to a disregarded entity under the default provisions of the check the box regulations.

Examination now seeks to extend the statute of limitations on assessment for ██████████ for the tax year ending December 31, ██████████. Examination has requested our advice regarding the proper procedure to accomplish this.

II. Issues.

1. What is the proper entity to execute a Form 872 Consent to Extend the Time to Assess Tax with regards to the tax liability of ██████████ for tax year ending December 31, ██████████?

2. Is any entity liable as a transferee under section 6901 for the tax liability of ██████████ for tax year ending December 31, ██████████ as a result of its deemed liquidation under the check the box regulations?

III. Conclusions.

1. Our office recommends that Forms 872 be secured from ██████████ and ██████████ respectively. The recommended captions of the Forms 872 are set forth below.

2. Since the application of transferee liability to our case is an unresolved issue, in the interest of protecting the fisc our office recommends that Forms 977 and 2045 be secured from ██████████.

IV. Discussion.

A. Introduction.

I.R.C. section 6501(a) provides generally that the amount of income tax must be assessed within three years from the filing of

the return.¹ Section 6501(c)(4) provides the authority for the Service and a taxpayer to enter into an agreement to extend the time to assess. Typically, to accomplish such an agreement, the Service and the taxpayer execute a Form 872, "Consent to Extend the Time to Assess Tax". Alternatively, in certain situations, the Service may seek to assert transferee liability against a party based on the transfer to that party of assets of the taxpayer. Section 6901. Typically, to accomplish this the Service and the transferee execute a Form 977 "Consent to Extend the Time to Assess Liability at Law or in Equity for Income, Gift, and Estate Tax Against a Transferee or Fiduciary" and a Form 2045 "Transferee Agreement."

B. Conversion to an LLC under Delaware law.

The conversion of an entity ("other entity") into an LLC under Delaware law is governed by Delaware Code Annotated, title 6, §18-214. 6 Del. C. §18-214(a) provides that a corporation is eligible to be converted to an LLC. The other entity must file a certificate of formation and a certificate of conversion with the Delaware Secretary of State. 6 Del. C. §18-214(b)(1) and (2). Upon the effective date of the certificate of conversion and the certificate of formation the other entity is converted into an LLC. 6 Del C. §18-214(d). The LLC is deemed to have commenced its existence on the date that the other entity was first "created, formed, incorporated or otherwise came into being." Id. 6 Del. C. §18-214(e) provides, in part, that the conversion shall not be deemed to affect any obligations or liabilities of the other entity incurred prior to the conversion.

According to 6 Del. C. §18-214(f), for purposes of Delaware law, all rights, privileges, powers and interests in property of the other entity shall remain vested in the LLC and shall be the property of the LLC. "All debts, liabilities and duties of the other entity that has converted shall remain attached" to the LLC and may be enforced against the LLC to the same extent as if the debts, liabilities and duties had originally been incurred or contracted by it in its capacity as an LLC. Id. The rights, privileges, powers and interests in property and the debts, liabilities and duties of the other entity are not deemed to have been transferred to the LLC for any purpose of Delaware law. Id.

6 Del. C. §18-214(g) provides that unless otherwise agreed or as required under non-Delaware law, the other entity is not

¹Unless otherwise indicated, all section references denote the Internal Revenue Code of 1986, as in effect for the year at issue.

required to wind up its affairs, pay its liabilities or distribute assets upon the conversion and the other entity is not deemed to dissolve as a result of the conversion. Id. The conversion constitutes a continuation of the other entity in the form of an LLC. Id. "[T]he limited liability company shall, for all purposes of the laws of the State of Delaware, be deemed to be the same entity as the converting other entity." Id.

C. Form 872 Consent executed by [REDACTED] due to conversion under Delaware law.

The issue becomes what is the proper entity or entities to consent to extend the time to assess.

[REDACTED] remains liable for the liabilities incurred by [REDACTED] prior to the conversion as if [REDACTED] had incurred it. 6 Del. C. §§18-214(e) and (f). [REDACTED] is not deemed to dissolve under Delaware law upon the conversion. See Del. C. §18-214(g). Rather, [REDACTED] continues in existence as [REDACTED]. Id. [REDACTED] is a separate legal entity but is deemed to be the same entity as [REDACTED]. See 6 Del. C. §§18-201(b) and 214(g). [REDACTED] is also deemed to commence on the formation or incorporation date of [REDACTED]. See 6 Del. C. §18-214(d). Given the treatment of the conversion under Delaware law, our office concludes that the taxpayer is [REDACTED] for purposes of extending the time to assess.²

Our office recommends that the proper caption on the Form 872 executed by an authorized party of [REDACTED] should be:

"[REDACTED] (EIN [REDACTED]) formerly [REDACTED] (EIN [REDACTED])" *

At the bottom of the Form 872 type:

" *This is with respect to the several liability for the consolidated tax of [REDACTED] and subsidiaries consolidated group for the tax year ending [REDACTED]."

²This conclusion does not take into account the application of the check the box regulations to the conversion. See, infra at D.

D. Form 872 Consent executed by [REDACTED] due to the check the box regulations.

The conversion of [REDACTED] into an LLC under Delaware implicates the check the box regulations. Upon the conversion of [REDACTED] into an LLC, the default provisions of the check the box regulations treat [REDACTED] as a disregarded entity for federal tax purposes. Treas. Reg. §301.7701-3(b)(1)(ii). As a result, [REDACTED] is deemed to liquidate into its single owner [REDACTED]. Treas. Reg. §301.7701-3(g)(1)(iii). Since [REDACTED] wholly owned [REDACTED] at the time of the deemed liquidation, the deemed liquidation is treated under section 332. The check the box regulations do not explain if the characterizations which result from the check the box regulations apply only prospectively or if the characterizations apply to consents for prior tax years. Based on our discussions with our National Office, we recommend that in such a situation as presented in our case Examination also secure a consent to extend the time to assess from the sole member ([REDACTED]) of the LLC ([REDACTED]) in its capacity as the single owner. [REDACTED]

(b)(5)(AC), (b)(7)a

Our office recommends that the proper caption on the Form 872 executed by an authorized party of [REDACTED] should be:

"[REDACTED] (EIN [REDACTED]) as successor to [REDACTED] (EIN [REDACTED]) and as alternative agent under Treas. Reg. §1.1502-77T(a)(4)(ii) for the members of the [REDACTED] consolidated group."*

At the bottom of the Form 872 type:

" *This is with respect to the federal income tax liability of the [REDACTED] (EIN [REDACTED]) and subsidiaries consolidated group for the tax year ending December 31, [REDACTED]."

E. Potential for Transferee Liability.

Another unresolved issue borne by the check the box regulations is whether [REDACTED] may potentially have transferee liability as a result of the deemed liquidation. In certain situations, the Service may seek to assert transferee liability against a party based on the transfer to that party of assets of

the taxpayer. Section 6901 governs transferee liability. Section 6901(a)(1) provides in part that the liability in law or equity of a transferee of property for income tax shall be assessed, paid and collected in the same manner and subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred. A transferee includes a distributee. Section 6901(h). A transferee includes a shareholder of a dissolved corporation. Treas. Reg. §301.6901-1(b).³

The check the box regulations broadly provide that,

"[t]he tax treatment of a change in the classification of an entity for federal tax purposes by election...is determined under all relevant provisions of the Internal Revenue Code and general principles of tax law, including the step transaction doctrine." Treas. Reg. §301.7701-3(g)(2).

Given the broad application of the check the box regulations, the deemed liquidation could be viewed as a transfer under section 6901. Since Treas. Reg. §301.7701-3(g)(1)(iii) deems a corporation to liquidate on the effective date of its conversion to an LLC, transferee liability may potentially be appropriate. According to our National Office, the interplay of a deemed liquidation under the check the box regulations and transferee liability has not yet been addressed. We recommend taking a conservative approach and securing Forms 977 and 2045 from [REDACTED] in addition to the Form 872.

(b)(5)(AC), (b)(7)a

³Generally, a transferee's liability is determined under state law. Commissioner v. Stern, 357 U.S. 39, 45 (1958). Under the trust fund doctrine, a shareholder who receives assets from a corporation in a dissolution is liable as a transferee for taxes incurred by the corporation prior to its dissolution. Lesser v. Commissioner, 47 T.C. 564, 589 (1967). Delaware courts have adopted the trust fund doctrine. In re Rego Company, 623 A.2d 92, 95 (Del. Ch. 1992). Delaware law provides that a dissolved corporation remains in existence for three years following the date of dissolution in order to wind up its affairs. 8 Del. C. §278. During this winding up period, an authorized representative of the corporation may sign a Form 872 consent to extend the time to assess but the extended period should not go beyond the winding up period.

(b)(5)(AC), (b)(7)a

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

If you have any questions, please feel free to contact attorney Robert T. Bennett of our office at (973) 645-3244.

JOSEPH F. MASELLI
Area Counsel
(Heavy Manufacturing and
Transportation:Edison)

By: /s/ William F. Halley
WILLIAM F. HALLEY
Associate Area Counsel
(Large and Mid-Size Business)

cc. Steve Kraemer, International Examiner